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CHARLES ELMORE CR

In the Supreme Court of the United States

OCTOBER TERM, 1950.

No. 705

THE GABRIEL COMPANY,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI
To the United States Court of Appeals
For the Sixth Circuit, and
BRIEF IN SUPPORT OF PETITION.

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In the Supreme Court of the United States

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PETITION FOR WRIT OF CERTIORARI
To the United States Court of Appeals
For the Sixth Circuit.

To the Honorable Fred M. Vinson, Chief Justice of the United States, and the Associate Justices of the Supreme Court of the United States.

Your Petitioner, The Gabriel Company, respectfully shows:

I.

SUMMARY STATEMENT OF THE MATTER INVOLVED.

This case involves a review of a decision of the Tax Court of the United States, finding a deficiency in excess profits tax of Petitioner for the year 1944 in the amount of $81,343.40 (R. 177), which decision has been affirmed by the United States Court of Appeals for the Sixth Circuit, by a divided Court (R. 189, 204). The issue presented concerns the right of Petitioner to claim as equity invested capital, in computing its excess profits tax for the taxable year ended December 31, 1944, the value of Petitioner's stock which Petitioner issued in May, 1925 (soon after Petitioner's organization as a corporation under the laws of

the State of Ohio) in exchange for the assets appurtenant to a business theretofore carried on by one Claude H. Foster (herein sometimes called "Foster"), pursuant to an agreement made between Petitioner and Otis & Company (herein sometimes called "Otis"), an investment banking firm of Cleveland, Ohio, to make such exchange of Foster's property for Petitioner's stock. There is no dispute as to the fact that such an agreement was made and that the property of Foster was transferred to Petitioner in exchange for its stock pursuant thereto. Neither is there any dispute as to any of the other facts which are involved in a determination of the issue here presented.

The Tax Court held, and the Court of Appeals for the Sixth Circuit, *by a divided court,* affirmed the holding, that Petitioner's Class A stock had been sold by Petitioner to Otis for cash in the amount which Otis had previously agreed to pay to Foster for his property, and that Petitioner had paid that amount of cash to Foster for his property, in spite of the fact that under the controlling written contracts Petitioner had no agreement with Foster about anything, and no agreement with anyone to sell any of its stock for cash, or to pay anything for Foster's property except stock. No question was raised of Petitioner's good faith, or of any effort on the part of Petitioner or anyone else to give the transaction, for tax purposes, a different form from that which it would normally take.

We have here a simple case of

(1) an agreement by Foster to sell his property to Otis for a definite amount of cash plus one-half of the Class B (the only voting) stock of a corporation to be organized by Otis to take over Foster's property and continue the business formerly carried on by Foster,

(2) the organization of a corporation (Petitioner) as contemplated by the contract with Foster,

(3) an agreement between Otis and that corporation that Foster's property should be transferred to the corporation in exchange for all of the corporation's stock except a small amount which had previously been subscribed for as an incident to the organization of the corporation,

(4) the sale of all of Petitioner's Class A (nonvoting) stock by Otis to the general public on a "when issued" basis,

(5) the transfer of Foster's property directly to the corporation as Otis' nominee and the issuance of the corporation's stock to Otis in exchange for that property, as had been agreed between Otis and the corporation, and

(6) the payment by Otis to Foster of the cash price which it had agreed to pay to Foster and the transfer by Otis to Foster's nominees of one-half of the voting stock of the corporation as agreed between Otis and Foster.

We believe there is no doubt that if Otis had been the outright owner for some time, with no strings attached, of the business formerly carried on by Foster, and had organized Petitioner to take that business over, and had made exactly the same agreement with Petitioner to exchange the property for Petitioner's stock as was made here, and if Otis had sold all the Class A (nonvoting) stock of Petitioner to the public prior to, or coincidently with, the transfer of the property to Petitioner, and had so reimbursed itself for the price which it had some time before paid to Foster for the property, plus some profit, the equity invested capital of Petitioner arising from the transaction would have been an amount equal to the market value of the stock of Petitioner which had been issued to Otis in exchange for the property. This would have been the simple and indubitable result of the transaction under the provi-

sions of Section 718(a) and Section 113(a) of the Internal Revenue Code. The question here before the Court is whether a different result was justified by the facts

(1) that Otis' contract with Foster for the purchase of the property was entered into only a few days before Otis' contract with Petitioner to transfer the property to Petitioner for Petitioner's stock,

(2) that Otis' contract with Foster specifically contemplated that Otis would organize a corporation and cause the property to be transferred to that corporation for its stock, and would sell the nonvoting stock to the public and transfer half of the voting stock to Foster's nominees, although it also expressly provided that Otis' obligation to pay Foster the agreed cash price for the property was "not in any manner conditioned upon or postponed to the incorporation of said * * * corporation nor conditioned upon nor postponed to the authorization of such proposed stock," (R. 78) and

(3) that the property was transferred directly from Foster to Petitioner, as the nominee of Otis, instead of being first transferred by Foster to Otis and then transferred by Otis to Petitioner.

Petitioner contends that the controlling fact in determining the amount of equity invested capital which Petitioner acquired as a result of the transaction is the fact that Petitioner acquired the property which represented the invested capital in exchange for its stock, under a contract with Otis which contained no significant provisions except the provision for such exchange, and that the amount of Petitioner's equity invested capital so arising cannot be affected by collateral agreements made by Otis with anyone else in connection with Otis' acquisition of the property.

II.

JURISDICTIONAL STATEMENT.

The date of the decree to be reviewed is February 6, 1951 (R. 189). The statutory provision which is believed to sustain the jurisdiction of this Court is Section 1254(1) of the United States Code, as enacted by the Act of June 25, 1948, chapter 646, 62 Stat. 928, reading as follows:

> "Cases in the courts of appeals may be reviewed by the Supreme Court by the following methods:
>
> "(1) By writ of certiorari granted upon the petition of any party to any civil or criminal case, before or after rendition of judgment or decree;"

The Court of Appeals for the Sixth Circuit has in this case "decided an important question of federal law which has not been, but should be, settled by this Court" (Supreme Court Rule 38(5)(b)).

III.

QUESTION PRESENTED.

The question presented is whether, in determining a corporation's equity invested capital under Section 718(a) of the Internal Revenue Code, under a stipulation that the corporation's stock was issued in exchange for *property* transferred to it by a party who had previously agreed to purchase that property from a third party for cash, the Tax Court is justified in treating the transaction as one in which the corporation's stock was issued for "money paid in" under Section 718(a)(1) of the Internal Revenue Code, rather than one in which the corporation's stock was issued for "property paid in" under Section 718(a)(2) of the Internal Revenue Code, where no question of good faith has been raised and where no claim has been made that the form of the agreements or the transaction was unreal or was adopted for any purpose of tax avoidance. Under the

facts involved in our particular case, the question is whether the Tax Court was justified in holding that Petitioner's stock was issued for *"money paid in"* rather than *"property paid in"* for the purpose of determining Petitioner's equity invested capital under Section 718(a) of the Internal Revenue Code, notwithstanding the stipulation that such stock was issued in exchange for Foster's property (R. 66, 68-69) pursuant to an agreement (R. 68, 82) between Petitioner and Otis which did not mention cash, or directly or indirectly refer to any agreement or transaction involving cash, and notwithstanding the fact that no question of good faith was raised, and no claim was made that the form of the agreements or the transaction was unreal or was adopted for any purpose of tax avoidance.

IV.

REASONS RELIED UPON FOR ALLOWANCE OF THE WRIT.

Your Petitioner relies upon the following reason for the allowance of the writ:

The decision of said Court of Appeals holding that Petitioner's equity invested capital is governed by the price paid by Otis to Foster, rather than by the value of the stock issued by Petitioner to Otis in exchange for said property, in spite of the fact that no claim has ever been made that this was a case in which a substituted basis should be applicable, was an erroneous decision involving an important question of Federal law which has not been, but should be settled by this Court, and is, in principle, in conflict with the decision of the Court of Appeals for the Third Circuit, involving an analogous question, in the case of *Hazeltine Corporation v. Commissioner,* 89 F. 2d 513 (1937). The decision should therefore be reviewed by this Court under its Rule 38(5)(b).

Your Petitioner presents to this Court, and files herewith as an exhibit hereto, a duly certified transcript of the

entire record in the case, as the same appears in the United States Court of Appeals for the Sixth Circuit.

WHEREFORE, your Petitioner prays that a writ of certiorari issue under the seal of this Court directed to the Court of Appeals for the Sixth Circuit, commanding said court to certify and send to this Court a full and complete transcript of the record and of the proceedings of said Court of Appeals had in the case numbered and entitled on its Docket "No. 11,174, The Gabriel Company, Petitioner, v. Commissioner of Internal Revenue, Respondent," to the end that this cause may be reviewed and determined by this Court as provided for by the statutes of the United States; and that the judgment herein of said Court of Appeals may be reversed by this Court, and for such further relief as to this Court may seem proper.

Dated April 27, 1951.

RICHARD INGLIS,
I. W. SHARP, and
L. H. DAVIS,
Counsel for Petitioner.

In the Supreme Court of the United States

OCTOBER TERM, 1950.

No. .....

THE GABRIEL COMPANY,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

I.

OPINIONS OF COURTS BELOW.

1. The findings of fact and opinion of the United States Tax Court (R. 157) are reported in 13 T. C. at page 559.

2. The opinion of the United States Court of Appeals for the Sixth Circuit (R. 190) is reported in 186 F. 2d at page 786.

II.

JURISDICTION.

1. The date of the decree to be reviewed is February 6, 1951. (R. 189.) The Statutory provision which is believed to sustain the jurisdiction of this Court is Section 1254(1) of the United States Code as enacted by the Act of June 25, 1948, Chapter 646, 62 Stat. 928, reading as follows:

"Cases in the courts of appeals may be reviewed by the Supreme Court by the following methods:

"(1) By writ of certiorari granted upon the petition of any party to any civil or criminal case, before or after rendition of judgment or decree;"

The Court of Appeals has in this case "decided an important question of federal law which has not been, but should be, settled by this Court" (Supreme Court Rule 38(5)(b)).

III.

STATEMENT OF THE CASE.

The summary statement of the matter involved set forth in the preceding Petition for a Writ of Certiorari under subdivision I thereof (pages 1 to 4) is hereby adopted and made a part of this Brief in connection with the more detailed statement of facts hereinafter set forth.

From 1911 until May 2, 1925, one Claude H. Foster (herein sometimes called "Foster") of Cleveland, Ohio, conducted a sole proprietorship engaged principally in the manufacture and sale of automobile shock absorbers. His business operations met with marked success and were very profitable. (R. 70, 91.) On April 20, 1925, Foster offered to sell the business and all its appurtenant assets (herein sometimes called "Foster's business") to Otis & Company (herein sometimes called "Otis"), a Cleveland investment banking firm, for $4,000,000.00 in cash plus enough more cash to cover all Federal taxes which Foster would be required to pay because of the transaction, plus one-half of the voting stock of the new corporation to be formed to take over the business. The stock was required to be issued to four named members of Foster's organization. Foster's offer was promptly accepted by Otis. (R. 68, 75.) A copy of the offer and acceptance follows:

Cleveland, Ohio, April 20, 1925

Messrs. Otis and Company
Cleveland, Ohio

Gentlemen:

Heretofore I have been carrying on my business as an individual under the name of the Gabriel Manufacturing Company. I now offer to sell this business to you, but only upon the terms and conditions that are laid down in this letter. I am making these conditions because I desire that the management of the company shall be in the hands of certain individuals in order that the management and policies which I have built up shall be continued. I am further anxious that the public shall be offered an opportunity to buy stock at a price which in all probability will return to the stockholders the total amount of their investment during the next five years. I am also, as a matter of friendship with your firm, entering into this transaction with you without competitive bidding, and it is my desire that your profits should be limited to whatever I consider a reasonable amount. I am attaching hereto a trial balance dated February 28, 1925, and a balance sheet of December 31, 1924. The business will be turned over to you in the condition shown on the trial balance of February 28, 1925, but subject to the ordinary changes arising out of the conduct of the business from that date; provided that as a part of the assets the cash turned over shall be $150,000.00, and said business to be subject to present salaries and bonuses to and including April 30th, 1925.

The following are the earnings of the business for the five years ending December 31, 1924, before deduction of Federal Income Tax but after all other charges:

1920	$ 797,894.49
1921	651,381.52
1922	1,327,715.83
1923	1,414,393.34
1924	1,241,366.07

These earnings are to be verified by an accountant satisfactory to you, whose expenses you will pay.

Predicated upon the verification of these figures, I hereby offer to turn over to you or a company to be formed by you the business in the condition outlined above, and also the real estate located in Cleveland which is now occupied by the factory. It is understood that none of the service stations, whether in Cleveland or elsewhere, nor the Canadian Company, are included in this sale. This sale includes all present American and Foreign patents covering the devices manufactured or owned in connection with the product manufactured by the American Company and also all applications for such patents. The Canadian Company, however, shall retain any patents and patent rights which it now enjoys in Canada. I understand that it is your plan to have the business taken over by an Ohio corporation, which shall have authorized 200,000 shares of no par value stock, of which 198,000 shares shall be Class "A" stock, and 2,000 shares shall be Class "B" stock. Both classes of stock shall be identical in all respects, except that the Class "B" stock shall have the sole voting rights. The Class "A" stock shall be offered to the public at not to exceed $25.00 per share, and you will use your best efforts to sell it at this price by means of a public offering throughout the United States. Of the 2,000 shares of Class "B" stock you will give 1,000 shares as I direct to the following members of my organization: George H. Ralls, David Benjamin, John F. Gibler and Rudolph J. Ketz. The remaining 1,000 shares of Class "B" stock shall be held by the firm of Otis and Company. In reference to the Class "B" stock to be issued to the above named individuals, a contract shall be made with such individuals, whereby, if any one or more of them desire to sell his stock, or if any one or more of them discontinues in the employ of the company, he or they shall offer, or such persons' administrator or executor shall offer to Otis and Company or its successor such Class "B" stock in exchange for Class "A" stock of the same number of shares.

I approve the foregoing plan, and it is understood that if for legal or other reasons another plan is

adopted for the distribution of this stock to the public, you will, before attempting such distribution, secure my approval.

I agree to remain in charge of the business as heretofore until December 31, 1925, at a salary of $2,000 per month. The price of said business shall be $4,000,000.00 to me in cash, it being understood that such price includes inventory of raw material, work in process and finish product at actual cost, accounts receivable and cash on hand to the amount of $150,000 as of the close of business on April 30th, 1925, and that the balance of such purchase price is attributable to real estate, plant and equipment, patents and good will. Said amount of $4,000,000.00 in cash shall be net to me, and in addition to all Federal income and profit taxes due from me on account of this transaction, and you are to reimburse me for the amount which I have to pay as Federal income and profit taxes because of this transaction. In preparing my tax return, however, I will consult with you and agree to make the return in such form that the amount payable by reason of this transaction shall be as small as the law will permit.

This offer shall become a contract between us as soon as you endorse acceptance by you at the foot hereof, and I agree to turn over the business within one week after the report of the auditor to you and to me on the subject of earnings and inventory and upon payment to me of said $4,000,000.00 in cash. It is understood that you will cause the audit to be made as rapidly as possible, and that you may and will make a public offering of the stock as soon as you indicate to me that the auditor's report indicates that the figures of earnings are substantially as submitted. I will agree to furnish you with the usual data concerning the history and earnings of the company for purposes of making a public offering of the stock. It is understood, however, that all expenses of incorporation and qualifying of the securities shall be borne by you.

It is also understood that in the event the auditor's report and verification prove substantially as represented in this offer and that you fail to enter into

the contract provided for in this offer by May second, 1925, at four o'clock P.M. of said day, and that you fail to comply fully with the payment of $4,000,000.00 in cash net to me by said time, and that you fail to comply with all the other obligations herein imposed upon you, I shall in such event have the right to declare this contract and offer cancelled by mailing notice addressed to you in the Cuyahoga Building, Cleveland, of such intention to cancel this contract and offer. It is also understood that the payment to me of said sum of $4,000,000.00 cash net to me is not in any manner conditioned upon or postponed to the incorporation of said proposed Ohio corporation nor conditioned upon nor postponed to the authorization of such proposed stock.

Very respectfully yours,

(s) C. H. Foster.

Accepted by Otis and Company,

By: (s) Chas. A. Otis.

Petitioner was incorporated on April 23, 1925, under the laws of the State of Ohio, with a capital stock consisting of fifty shares of Class A and fifty shares of Class B stock. The two classes of stock were alike in all respects except that all voting power was vested in the Class B stock. On the date of incorporation the entire 100 shares of Class A and Class B stock were subscribed for at $25 per share. (R. 65-66.)

On April 24, 1925, there was presented to Petitioner an offer from Otis, which was accepted by Petitioner on the same day. (R. 68, 82.) A copy of said offer follows:

April 24th, 1925.

To The Gabriel Snubber Manufacturing Company,
Cleveland, Ohio.

The undersigned, Otis & Company, hereby offers to procure to be conveyed, assigned and transferred to your Company all of the property, assets and good will of the business owned by Claude H. Foster and con-

ducted by him under the name of Gabriel Manufacturing Company, with the exceptions hereinafter noted; such business shall be turned over in the condition shown on its trial balance of February 28th, 1925, subject to ordinary changes arising out of the conduct of the business from that date, and subject also to present salaries and bonuses to and including April 30th, 1925.

Briefly described, the property consists of the real estate and manufacturing plant located thereon, situated in the City of Cleveland, at 1407 East 40th Street, together with all machinery, equipment, inventory and supplies on hand, and bills and accounts receivable, and as part of said assets, the sum of One Hundred Fifty Thousand Dollars in cash. The transfer shall also include all American and foreign patents covering the devices manufactured or owned in connection with the product, but excluding all patents and patent rights owned by the Canadian Company, controlled by Mr. Foster. There shall also be excluded all service stations, whether in Cleveland or elsewhere. The undersigned will also arrange with Mr. Foster to remain in charge of the business until December 31, 1925, at a salary of Two Thousand Dollars per month.

In consideration therefor you shall, if you accept this offer,—(a) repay to the undersigned in cash all amounts advanced or which may be advanced for charter fees, accountants' and attorneys' fees, appraisals, certificates, stamp taxes, and other expenses incident to the organization of your Company and issuance of its stock;—(b) increase your authorized capital stock to 200,000 shares of no nominal or par value, of which 198,000 shares shall be designated as Class A without voting power, and 2,000 shares shall be designated as Class B possessing the sole voting power of the Company. All of such increase of capital stock shall be issued to the undersigned or to its nominees as fully paid and non-assessable. Conveyances, assignments and transfers of the property and business as a going concern shall be made as promptly as possible, and in any event not later than May 2nd, 1925.

Inasmuch as a portion of the assets proposed to be transferred to you in payment for stock has been derived from earnings of the property, it is expressly stipulated that not less than $500,000.00 of such assets shall be set up on your books as a surplus, available for dividend purposes.

Respectfully submitted,

OTIS & COMPANY,
By (s) J. O. EATON.

On April 25, 1925, Petitioner's authorized capital stock was increased to 198,000 Class A shares and 2,000 Class B shares. On April 27, 1925 Otis offered the entire 198,000 shares of Class A stock for sale to the general public on a "when issued" basis at $25 per share and the issue was immediately heavily oversubscribed. (R. 66, 69, 73, 99.)

During the week ended May 1, 1925, 30,600 shares of Petitioner's Class A stock were traded in on the New York Curb Exchange at prices ranging from a low of 26 to a high of 27⅝ and thereafter said stock was actively traded in on said exchange and the New York Stock Exchange at prices which during the remainder of the year 1925 ranged from a low of 26 to a high of 39⅞. (R. 71-72.)

On May 2, 1925, all of the 197,950 Class A shares and 1,950 Class B shares authorized upon the increase of Petitioner's capital stock were issued to Otis, or the nominees of Otis *in exchange for Foster's business,* which was transferred by Foster directly to Petitioner, *at the request of Otis.* (R. 66, 68-69.)

In payment for the business and assets which were so transferred to Petitioner at the request of Otis, Foster received *from Otis* $4,358,705.70 in cash (of which amount the excess over $4,000,000.00 represented reimbursement for Federal taxes on the transaction) and *Otis* transferred to the four members of Foster's organization named in the contract between Foster and Otis 1,000 shares of Petitioner's Class B stock. (R. 69-70.)

In Petitioner's excess profits tax return, Petitioner claimed as invested capital $5,000,000.00 as "property paid in for stock, paid in surplus, or contributions to capital" arising out of the exchange of Petitioner's stock for Foster's property on May 2, 1925 under the circumstances above set forth. The Commissioner decreased said amount to $4,358,705.70, the amount of the cash payment made by Otis to Foster, including coverage of his taxes resulting from the transaction. (R. 164.) The Tax Court allowed Petitioner as equity invested capital only an additional $25,000.00 ($25 per share) for the 1,000 shares of Class B stock which Otis transferred to Foster's nominees pursuant to its agreement with Foster (R. 167), and the Court of Appeals affirmed this action of the Tax Court (R. 189, 204). The net result was that Petitioner was allowed as its equity invested capital, the amount which was found to have been paid by Otis to Foster for Foster's business, instead of the amount which was paid by Petitioner to Otis for that business. Judge Miller of the Court of Appeals wrote a strong dissenting opinion fully supporting the position of Petitioner on the issue presented in this Petition. (R. 204.)

No claim has been made at any time that the agreements and transactions between Foster and Otis and between Otis and Petitioner took the form they did, rather than some other form, in order to obtain any tax advantage to Petitioner or any other party. Nor has it ever been suggested that Petitioner should be relegated to any "substituted basis" for the property it acquired on June 2, 1925, or that Petitioner's equity invested capital arising out of that transaction should be other than the "money paid in" or "property paid in" for Petitioner's stock, as provided in Section 718(a) of the Internal Revenue Code, or that if *property* was paid in for stock, such property should be included at any other amount than its cost basis as provided in Section 113(a) of the Internal Revenue Code.

The only issue is whether Foster's property was paid in to Petitioner for Petitioner's stock, as the agreement be-

tween Otis and Petitioner expressly provides, or whether, notwithstanding the express provisions of the only agreement which Petitioner had with reference to the acquisition of Foster's property or the issuance of Petitioner's stock, it should be held, as a *legal conclusion,* arising from the *undisputed facts* that *cash* was paid in to Petitioner by Otis for Petitioner's stock, and used by Petitioner to buy Foster's business from Foster, making "*money paid in*" rather than "*property paid in*" the basis of Petitioner's equity invested capital under Section 718(a) of the Internal Revenue Code.

It should be noted that the Tax Court did not in its "Findings of Fact" (R. 158-164) make any *finding* that any cash was paid in for Petitioner's stock. Nevertheless, it stated in its *Opinion* the *conclusion* that Petitioner was entitled to include in its equity invested capital "the amount of $4,358,705.70, representing cash paid by Otis on behalf of the Petitioner in securing Foster's business and assets and, in addition the sum of $25,000.00, which we have determined to be the fair market value of the 1,000 shares of Class B stock, which were transferred to the four Foster executives" (R. 167); notwithstanding its own statement earlier in the Opinion (R. 166) that "From the sale of its Class A stock, Petitioner never received any money as such * * *."

The Tax Court expressly stated that in view of the "interpretation" which the court had placed upon the transaction in question, the court thought it was unnecessary to consider the Petitioner's proposals that the assets acquired should be valued under the principles set out in Regulations 112, Section 35.718-1 or A. R. M. 34, 2 C. B. 31. (R. 167.) The court made no finding as to the value of the assets for which Petitioner exchanged its stock, or the value of the stock which substantially represented those assets, because, under the "interpretation" which the court placed on the transaction, *cash* rather than *property* was held to

have been "paid in" to Petitioner for its Class A stock, and it was unnecessary to determine the value of the property which the court treated as having been purchased with cash.

IV.

SPECIFICATION OF ERRORS.

Petitioner contends that the Court of Appeals erred in the following respects:

1. In holding that the transactions here involved amounted, as a matter of law, to the payment of *cash* in the amount of $4,358,705.70 to Petitioner by Otis for Petitioner's Class A stock, and the use by Petitioner of that cash to purchase Foster's business; and

2. In holding that Otis did not pay in *property* to Petitioner for Petitioner's Class A stock, as well as its Class B stock, in spite of the fact that the only agreement Petitioner had with Otis, and the only agreement Petitioner had with anyone relating to the disposition of its stock or to the acquisition of Foster's business, expressly provided for the issuance of all of Petitioner's stock (except the 100 shares originally subscribed for at the time of Petitioner's organization) in exchange for the *property* represented by Foster's business.

V.

PROVISIONS OF STATUTE AND REGULATIONS INVOLVED.

Section 718(a) of the Internal Revenue Code (26 U. S. C. Section 718(a)) provides:

> "(a) *Definition.* The equity invested capital for any day of any taxable year shall be determined as of the beginning of such day and shall be the sum of the following amounts, reduced as provided in subsection (b)—
>
> (1) *Money Paid-In.* Money previously paid in for stock, or as paid-in surplus, or as a contribution to capital;

> (2) *Property Paid-In.* Property (other than money) previously paid in (regardless of the time paid in) for stock, or as paid-in surplus, or as a contribution to capital. Such property shall be included in an amount equal to its basis (unadjusted) for determining loss upon sale or exchange.* * *"

Section 113(a) of the Internal Revenue Code (26 U. S. C. Section 113(a)) provides:

> "(a) *Basis (Unadjusted) of Property.* The basis of property shall be the cost of such property; except that—" (exceptions inapplicable)

Regulations 112, Section 35.718-1, under the heading "Determination of Daily Equity Invested Capital—Money and Property Paid In" provides in its second paragraph:

> "If the basis to the taxpayer is cost and stock was issued for the property, the cost is the fair market value of such stock at the time of its issuance. If the stock had no established market value at the time of the exchange, the fair market value of the assets of the Company at that time should be determined and the liabilities deducted. The resulting net worth will be deemed to represent the total value of the outstanding stock. In determining net worth for the purpose of fixing the fair market value of the stock at the time of the exchange the property paid in for such stock shall be included in the assets at its fair market value at that time."

VI.

SUMMARY OF ARGUMENT.

When a taxpayer corporation issues its stock in exchange for property pursuant to an agreement which makes no reference to, and is not conditioned upon, any previous agreement or transaction between the transferor and any third party, and when there is no question involved of a substituted basis for the property, the property must, as a matter of law, be considered to have been paid in as equity invested capital of the corporation in an amount equal to the *cost* of the property to the corporation, which *cost is*

the market value of the stock issued by the corporation in exchange for the property. The fact that the transferor of the property to the corporation sells the stock which he receives from the corporation in exchange for the property to the general public for cash, and uses part of that cash to pay the price which he undertook to pay to the former owner of the property, cannot affect the equity invested capital of the corporation arising out of the acquisition of the property in exchange for its stock.

VII.

ARGUMENT.

The controlling facts with reference to the issue here presented are all stipulated. The only question is the legal question as to whether under the existing circumstances the Tax Court and the Court of Appeals were justified in holding that the transaction by which on June 2, 1925, Petitioner acquired certain property formerly owned by Foster, in exchange for 199,900 shares out of its 200,000 shares of authorized capital stock, was, in legal effect, something else than it was agreed to be in the written documents pursuant to which the transaction was carried out.

Foster had agreed on April 20, 1925, to transfer his business to Otis for $4,000,000.00 cash plus enough additional cash to pay his income taxes on the transaction, which turned out to be $358,705.70, plus 1,000 shares out of the 2,000 shares of Class B (voting) stock of the corporation to be organized by Otis to take over the property and carry on the business. On April 23, 1925, Petitioner was incorporated, and on April 24, 1925, Petitioner accepted an offer from Otis to transfer to Petitioner the business and assets which Otis had previously agreed to purchase from Foster, in exchange for 197,950 Class A shares and 1950 Class B shares of Petitioner plus reimbursement for the organization expenses incurred in connection with Petitioner's organization. On May 2, 1925, Foster's business

and assets were transferred by Foster directly to Petitioner, *at the request of Otis,* and Petitioner issued the 197,950 Class A shares and 1,950 Class B shares to Otis and the nominees of Otis, as it had agreed to do in its contract of April 24, 1925, with Otis.

The first contract (between Foster and Otis) (R. 75) provided for the sale of the business and assets by Foster to Otis for cash plus one-half of one per cent of the shares of stock of the corporation to be organized. The second contract (between Otis and Petitioner) (R. 82), which is stipulated to have been the only contract that Petitioner had with reference to the issuance of any of its stock (R. 69), did not in any way refer to the first contract between Foster and Otis, nor did it refer in any way to the sale of Petitioner's stock to the public by Otis or to the payment of the price for the property agreed upon between Foster and Otis. Nevertheless, the Tax Court and the majority of the judges of the Court of Appeals held that Otis had underwritten Petitioner's Class A stock for the amount of cash Otis had agreed to pay Foster, and had paid Foster that amount of cash on behalf of Petitioner. (R. 167.)

It seems clear to us that the Courts below tore apart the transactions which the parties actually carried through, pursuant to binding legal agreements which the parties had entered into, and remade them in a new pattern which did not conform to the facts or to the agreements, in order to reduce Petitioner's invested capital arising out of the transaction to the amount paid by Otis to Foster, instead of recognizing as invested capital the larger amount representing the price paid by Petitioner (in stock) to Otis for the property.

We maintain that there is no justification for a court's ignoring the form and legal effect of the transactions carried on by taxpayers, where no question of good faith has been raised, and especially where there is no intimation that there is any lack of reality in the form adopted or that

the form was adopted for any purpose of tax avoidance. *United States v. Isham,* 17 Wall. 496, 506 (1873); *Bullen v. Wisconsin,* 240 U. S. 625, 630 (1916); *U. S. v. Cummins Distilleries Corporation,* 166 F. 2d 17, 20-21 (6th Cir. 1948); *Chisholm v. Commissioner,* 79 F. 2d 14 (2nd Cir. 1935).

Under the stipulated facts the conclusions seem inescapable that Petitioner:

(1) Did not buy the business from Foster.

(2) Did not sell its stock to Otis for money, and

(3) Did not pay for Foster's business with cash.

It is true that Foster sold his business for $4,358,705.70 cash (plus one-half of Petitioner's voting stock) but that sale was to Otis not to Petitioner. Petitioner was not even in existence at the time the agreement for the sale was made. The later sale of the same property by Otis to Petitioner was evidenced by an entirely separate and distinct contract with totally different terms.

It is clear from the contract between Otis and Petitioner that Petitioner bought a business and its appurtenant assets from Otis, which was then their owner, and that payment was made in stock—not in cash. This contract, dated April 24, 1925 (R. 82), provides that in consideration of Otis's procuring a conveyance of Foster's business and assets to Petitioner, Petitioner will reimburse Otis for certain expenses, increase its authorized capital stock to 200,000 shares and issue all of the increase of its capital stock to Otis as fully paid and nonassessable. The last paragraph of the contract refers to the assets "proposed to be transferred to you (Otis) in payment for stock." (R. 83.) The stipulated facts state that Petitioner had no other agreement with reference to the issuance of its stock. (R. 69.) No cash figure is mentioned in the contract as the purchase price. It contains no provision respecting any resale of the stock to the public nor any provision concerning the disposition of the proceeds to be received by

Otis from any resale. In fact, so far as the agreement between Petitioner and Otis is concerned, Otis might have retained all of the stock of Petitioner indefinitely. Any obligation to do otherwise arose entirely out of Foster's contract with Otis to which Petitioner was not in any way a party.

The stipulated facts state that all the shares of stock arising out of the increase "were issued to Otis and Company * * * in exchange for all of the assets, including good will, of the business, * * *." (R. 66.) It seems clear that Otis not only purchased Petitioner's stock on its own account but also paid for that stock by transferring to Petitioner the business and property of Foster as it had agreed to do. Petitioner did not in fact receive any money for its stock. (R. 166.)

Under Sections 718(a)(2) and 113(a) of the Internal Revenue Code the equity invested capital of a corporation includes property previously paid in for stock, valued at its cost basis. Section 35.718-1 of Regulations 112 provides:

> "If the basis to the taxpayer is cost and stock was issued for the property, the cost is the fair market value of such stock at the time of its issuance."

It is our contention that the Tax Court was required as a matter of law to determine the fair market value of the stock issued to Otis at the time of its issuance, and allow that amount as equity invested capital of Petitioner arising out of the transaction with Otis. There was stipulated evidence of extensive market transactions in the stock, showing a fair market value for the stock which was substantially in excess of the price paid by Otis to Foster.

What Foster received for the property through a noncompetitive sale, accompanied by unusual conditions of his own choosing, is not controlling. Instead it is necessary to determine the fair market value of what Petitioner gave

in exchange for the property, which was Petitioner's stock. Even if the value of the property exchanged for stock (rather than the value of the stock exchanged for the property) were to be taken as the test, the value *at the time the property was received* would be the investment, even though that value was substantially larger than a price the transferor may have paid for it shortly before. *The Markenheim Co.*, 1 B. T. A. 1240 (1925), *Cassidy Company, Inc.*, 11 B. T. A. 190 (1928). This is entirely different from recognizing as invested capital a value which includes *increase after the taxpayer acquired the property*, such as was involved in *LaBelle Iron Works v. United States*, 256 U. S. 377 (1921).

Even if we accepted the view of the Tax Court that the transactions between Foster and Otis and those between Otis and Petitioner should be considered as a whole, and not divided into separate transactions as they were by the parties for reasons entirely unrelated to the tax consequences with which we are here concerned, the net result was that the taxpayer acquired the business and assets of Foster in exchange for its stock. The fair market value of the stock and the fair market value of the business and assets represented by the stock *at the time of the exchange* are the decisive elements in determining the *investment*, which constitutes Petitioner's equity invested capital, whether the problem be viewed as one of cost to the corporation in stock, or one of the additions made to the corporation's assets in consideration for its stock. It is really unimportant whether the property which Petitioner received be considered to have been transferred to Petitioner by Otis or by Foster or by Otis and Foster together. In any event, Petitioner paid for it in stock, and what Otis and Foster did with the stock, or with the proceeds of the sale of the stock, cannot affect Petitioner's invested capital.

Inasmuch as under Section 718(a)(2) of the Internal Revenue Code property paid in for stock is to be included

in equity invested capital in an amount equal to its basis (unadjusted) for determining loss upon sale or exchange, and under Section 113(a) of the Code that basis is the cost of the property so paid in to the issuer, and under Sections 113 and 114 of the Code cost is also the basis for depreciation of any property so paid in, the problem is exactly the same here as if all the property Petitioner received from Otis had been depreciable property, and we were determining the basis for depreciation of that property. Just such a problem was involved in the case of *Hazeltine Corporation v. Commissioner,* 89 F. 2d 513 (3rd Cir. 1937).

The facts of that case may be summarized as follows:

> Hazeltine Research Corporation owned certain valuable patent rights in inventions developed by Hazeltine relating to neutrodyne radio receivers and valuable contracts with Independent Radio Manufacturers, Inc. (sometimes referred to as I. R. M.), the stockholders of which were a number of radio manufacturers interested in obtaining the right under the Hazeltine inventions to manufacture receivers including the Neutrodyne arrangement. On February 2, 1924 Hazeltine, Hazeltine Research Corporation, one Taylor (who had been instrumental in bringing the parties together) and the investment firm of Foster, McConnell & Co. entered into a contract providing that Hazeltine Corporation (the taxpayer here involved) would be organized under Delaware law with 200,000 shares of no par value stock; that Hazeltine Research Corporation would transfer to the new corporation its patents and rights in inventions and trade names and its agreements with I. R. M. together with any business and good will of the Research Corporation associated with said assets; that upon its acquisition of this property the new corporation would issue 155,250 shares of its stock to the Research Corporation and 14,750 shares to Taylor in consideration of the transfer by Taylor of certain related inventions obtained from another party; and that Foster, McConnell & Co. would subscribe for 5,000 shares at $10 per share and the balance of 25,000 shares would remain

unissued until further order of the directors. It was further provided that the Research Corporation would immediately transfer 135,000 shares of the stock to Foster, McConnell & Co. for $650,000 cash payable on delivery of the stock.

Hazeltine Corporation (the taxpayer) had actually been organized on January 29, 1924. The first meeting of its Board of Directors was held February 15, 1924. At this meeting the contract of February 2, 1924 was ratified and the directors determined pursuant to the Delaware Statute that the value of the assets to be received for the 170,000 shares of stock to be issued to the Research Corporation and Taylor was $3,500,000. Prior to this meeting Foster, McConnell & Co. had proceeded with the preparations for marketing the 140,000 shares of stock. A syndicate had been organized and on February 11, 1924 public trading in the taxpayer's stock had begun on the New York Curb Exchange on a "when, as and if issued" basis. The firm had also organized H. N. Corporation and had assigned to it the firm's interest in the contract of February 2, 1924. Verbal notice of intent to proceed under the contract had been given by the firm to the other parties on or before February 11, and on February 15, 1924 H. N. Corporation by written notice called for performance of the contract by February 20, 1924.

On February 19, 1924 the Research Corporation executed an assignment of the Neutrodyne patents and applications and trademarks to the taxpayer followed on February 20 by separate assignments of the specific patent applications and inventions and the I. R. M. contract. On the same day Taylor executed an assignment of the invention he had contracted to transfer to the taxpayer. On February 18, 1924 the Research Corporation executed an assignment of 135,000 shares of stock of the taxpayer to Foster, McConnell & Co. Stock certificates dated February 18, 1924 were prepared as follows:

T-1 Hazeltine Research Corporation	135,000 shares
T-2 Foster, McConnell & Company	5,000 shares
T-3 Hazeltine Research Corporation	20,250 shares
T-4 Willis H. Taylor	14,750 shares

All of these certificates were delivered on February 19 to the parties in whose names they were issued, except T-1. On February 19, certificates T-1 and T-2 were cancelled and new certificates T-5 to T-1192, inclusive, for a total of 140,000 shares, were issued for distribution on February 20 to participants in the Syndicate and purchasers on the Curb. On February 19 Research Corporation received the check of H. N. Corporation for $650,000. These transactions were simultaneous and completed the performance of the contract of February 2, 1924. On or about February 20, 1924 Foster, McConnell & Co. and an associate firm issued a prospectus offering 140,000 shares for sale at $10 a share. The stock was largely oversubscribed prior to its issuance. Trading on the New York Curb Exchange on a "when, as and if issued" basis continued from February 11 until after the formal offering. Between February 13 and February 25, inclusive, 36,600 shares were sold on that Exchange. On February 19, the date of the transfer, 4,500 shares were sold on the Curb at prices ranging from 13¾ to 15 and averaging 14⅜.

The Court of Appeals affirmed the holding of the Board of Tax Appeals that the basis of the property which was acquired for stock of the taxpayer was the fair market value of the stock given in exchange for it, but differed from the Board on that value. The Board had found the value of the stock to be $10 per share, based primarily upon the fact that the investment bankers had paid $10 per share cash for 5,000 shares purchased from the taxpayer and had been able immediately to sell all of the 135,000 shares which it had purchased from the Research Corporation for approximately $10 per share. The Court of Appeals held that inasmuch as the entire block of stock offered at $10 per share was largely oversubscribed prior to its issuance, the sales prices fixed between the organizers prior to the date of issuance did not reflect the market price on that date, and that the market price of the stock, and consequently the basis of the property which was acquired in exchange for the stock, should be determined on the evidence of the sales

which took place on the Curb Exchange at about the time of the exchange of the stock for the property.

In our case we have a strictly analogous situation to that which existed in the *Hazeltine* case. The stock of Petitioner had been actively traded in on a "when issued" basis on the New York Curb Exchange for several days prior to the issuance of the stock in exchange for Foster's business and assets. The price range in such sales was from low of 26 to a high of 27⅝. (R. 71.) The stock was also actively traded in on the New York Curb Exchange and the New York Stock Exchange subsequently to its issuance, and never during the remainder of the year 1925 at a price less than $26 per share. (R. 71-72.) The Tax Court and the Court of Appeals in our case, unlike the Court of Appeals for the Third Circuit in the *Hazeltine* case, ignored this controlling evidence of the value of the stock which was issued in exchange for Foster's property, and so constituted the basis of Foster's property in the hands of Petitioner, and relegated Petitioner to the price paid by Otis to Foster as Petitioner's basis. This result was accomplished by saying that Petitioner had raised money for the purchase of Foster's property by the sale of its stock to Otis and then had used that money to buy Foster's property, notwithstanding the inconsistency of such a result with the controlling documents and stipulated facts which have been discussed in the earlier portion of this Brief.

Petitioner strongly urged the *Hazeltine* case on both the Tax Court and the Court of Appeals as a controlling authority. The Tax Court conveniently ignored the *Hazeltine* case altogether, and the Court of Appeals said that case was "far afield, involving as it did the depreciation basis of the property acquired by a corporation in exchange for its stock." (R. 203.) We submit that the *Hazeltine* case instead of being "far afield" is directly in point, inasmuch as it, like our case, was concerned with the *basis* of property acquired by the taxpayer corporation in

exchange for its stock, and the mere fact that the basis, when once determined, was to be used for depreciation purposes in the *Hazeltine* case and for invested capital purposes in our case made no difference whatever in the legal principle involved. It is submitted that the decision of the Court of Appeals for the Sixth Circuit in our case is irreconcilable with, and in fact directly contrary in legal principle to, the decision of the Court of Appeals for the Third Circuit in the *Hazeltine* case, and that this conflict between the principles of law applied by the two Courts of Appeals should be settled by a decision of this Court.

VIII.

CONCLUSION.

It is therefore respectfully submitted that this case is one calling for the exercise by this Court of its supervisory powers, by granting a writ of certiorari and thereafter reviewing and reversing said decision of the Court of Appeals for the Sixth Circuit.

Respectfully submitted,

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In the Supreme Court of the United States

OCTOBER TERM, 1950

No. 705

THE GABRIEL COMPANY, A CORPORATION,
PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Tax Court (R. 157–167) is reported at 13 T. C. 559. The opinion of the Court of Appeals (R. 190–204) is reported at 186 F. 2d 786.

JURISDICTION

The judgment of the Court of Appeals was entered February 6, 1951. (R. 189.) The petition for a writ of certiorari was filed April 30, 1951. The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254.

QUESTION PRESENTED

Whether in computing its excess profits tax the taxpayer corporation may include in its "equity invested capital," as defined in Section 718 (a) of the Internal Revenue Code, profits realized by an underwriter on the sale of its stock.

STATUTE INVOLVED

Internal Revenue Code:

> SEC. 718 [Added by Section 201, Second Revenue Act of 1940, c. 757, 54 Stat. 974]. EQUITY INVESTED CAPITAL.
>
> (a) *Definition.*—The equity invested capital for any day of any taxable year shall be determined as of the beginning of such day and shall be the sum of the following amounts, reduced as provided in subsection (b)—
>
> (1) *Money Paid In.*—Money previously paid in for stock, or as paid-in surplus, or as a contribution to capital;
>
> (2) *Property Paid In.*—Property (other than money) previously paid in (regardless of the time paid in) for stock, or as paid-in surplus, or as a contribution to capital. Such property shall be included in an amount equal to its basis (unadjusted) for determining loss upon sale or exchange. * * *
>
> * * * * *

(26 U. S. C. 1946 ed., Sec. 718.)

STATEMENT

The facts are stipulated (R. 65–101) and were found by the Tax Court as stipulated (R. 158–164). They may be summarized as follows:

Taxpayer corporation was organized in 1925 pursuant to an agreement between Foster, sole proprietor of a business, and Otis & Company, investment bankers. Under the agreement Otis was to market all of taxpayer's Class A (non-voting) stock to the public at a reasonable profit, and taxpayer was to purchase Foster's business assets with the net cash proceeds and one-half of taxpayer's Class B (voting) stock. Pursuant to the agreement, Otis organized the taxpayer corporation and sold to the public on a "when issued" basis all of taxpayer's authorized Class A stock (198,000 shares) at $25 per share, or a total of $4,950,000. Out of the proceeds Otis paid over to Foster on taxpayer's behalf $4,358,705.70, the cash portion of the price payable by taxpayer for Foster's business; and Foster transferred his business assets to taxpayer in exchange for that amount of cash and 1,000 shares (one-half) of taxpayer's Class B stock. For its underwriting services Otis retained the difference between what it paid for taxpayer's Class A stock ($4,358,705.70) and the price at which it sold the stock to the public ($4,950,000), and in addition it received 1,000 shares (one-half) of the Class B stock. (R. 68–70, 75–78, 85–88, 158–162.)

In its excess profits tax returns for 1942 and subsequent years taxpayer claimed equity invested capital of $5,106,204.26 as of the beginning of 1942. The Commissioner determined that a portion of the amount claimed represented underwriter's commissions not includible in taxpayer's equity invested capital, and computed an excess profits tax deficiency for 1944. (R. 32, 48–50, 164.) The Tax Court agreed with the Commissioner. It held that taxpayer's equity invested capital consisted of the net amount of cash received from the sale of its A stock ($4,358,705.70), plus the fair market value ($25,000) of the 1,000 shares of B stock issued for Foster's property; and that the commissions received by Otis were not includible in taxpayer's equity invested capital. (R. 164–167.) The Court of Appeals, one judge dissenting, affirmed. (R. 190–206.)

ARGUMENT

1. Section 718 (a) of the Internal Revenue Code, *supra,* p. 2, defines "equity invested capital" for purposes of determining the excess profits credit of a corporation[1] as the sum of (1) "money paid in" and (2) "property paid in" for stock. In

[1] The excess profits tax is imposed upon the "adjusted excess profits net income." (Section 710.) The chief adjustment factor is the "excess profits credit," which may be determined in either of two ways—under the "income" method (Section 713) or the "invested capital" method (Section 714). Taxpayer here computed its excess profits credit on the invested capital basis.

holding that the profit realized by Otis & Company on the sale of taxpayer's Class A stock to the public was not includible in taxpayer's equity invested capital, the courts below followed the established rule that only the net amount received by a corporation for its stock may be taken into account. Commissions or profits retained by an underwriter or broker in connection with the marketing of the stock do not represent invested capital within the meaning of Section 718 (a). They are paid to procure the invested capital, but are not a part of it for purposes of computing excess profits tax liability. *Simmons Co.* v. *Commissioner,* 33 F. 2d 75 (C. A. 1), certiorari denied, 280 U. S. 588; *Warner Co.* v. *Commissioner,* 11 T. C. 419, 432–434, affirmed *per curiam,* 181 F. 2d 599 (C. A. 3); *Cleveland Graphite Bronze Co.* v. *Commissioner,* 10 T. C. 974, 986–7, affirmed *per curiam,* 177 F. 2d 200 (C. A. 6); *Palomar Laundry Co.* v. *Commissioner,* 7 T. C. 1300; *Graton & Knight Co.* v. *Commissioner,* decided August 22, 1949 (1949 P-H T. C. Memorandum Decisions, par. 49206); A. R. R. 6970, III–1 Cum. Bull. 390 (1924). Cf. *LaBelle Iron Works* v. *United States,* 256 U. S. 377; *American Business Credit Corp.* v. *Commissioner,* 9 T. C. 1111, 1118.

Even though commissions paid to an underwriter or broker in connection with the sale of stock may constitute capital expenditures of the corporation, not all capital expenditures represent "invested capital" as that term is used in

Section 718 (a). See *Simmons Co.* v. *Commissioner, supra; Palomar Laundry Co.* v. *Commissioner, supra.* In *LaBelle Iron Works* v. *United State, supra,* this Court stated (p. 387) that invested capital for excess profits tax purposes has reference only to "capital actually embarked" in the business. See also *Willcuts* v. *Milton Dairy Co.,* 275 U. S. 215. Applying that concept, the Court of Appeals in the *Simmons Co.* case, *supra,* held that a corporation whose stock was sold to the public through bankers could include in its invested capital only the net proceeds of the sale, exclusive of the commission paid to the bankers.[2] This Court denied certiorari, and there is no more occasion for further review of this case than of that one.

2. Taxpayer's petition proceeds upon the hypothesis, rejected by both courts below, that its Class A stock was issued for "property" rather than for "money."[3] It is plain from the prospectus

[2] The statutory provision under construction in the *Simmons Co.* case (Section 326 (a) of the Revenue Act of 1918, c. 18, 40 Stat. 1057) was the forerunner of, and substantially the same as, Code Section 718 (a) here involved.

[3] Where stock is issued for "property," Section 718 (a) (2) applies and the adjusted basis of the property is includible in invested capital. Section 35.718–1 of Regulations 112 (quoted in fn. 2 of the Tax Court's opinion (R. 165)) provides that if the basis of property to the taxpayer is cost, and if the stock had a fair market value at the time of its issuance, the cost of the property is deemed the fair market value of the stock. If the stock had no established market value, the net worth of the company is deemed to represent the total value of the outstanding stock.

under which the Class A shares were sold (R. 85–88), to say nothing of the other stipulated facts (R. 69, 161), that the A shares were sold to the public by Otis on a when-issued basis for $25 per share. That taxpayer used the net cash proceeds to purchase property does not alter the fact that the A stock was sold for "money" as that term is used in Section 718 (a) (1).

The error in taxpayer's approach is compounded by its corollary assumption that Otis purchased Foster's property and then resold the property to taxpayer in exchange for taxpayer's stock. As is plain from the stipulated facts, and as the Tax Court pointed out (R. 165–167), Otis, acting in the capacity of underwriter, bought and resold taxpayer's stock, not Foster's property.[4] It organized taxpayer corporation to purchase the property, and enabled taxpayer to raise the cash portion of the price by marketing its Class A stock to the public. It sold the A stock for $4,950,000, turned over $4,358,705.70 to Foster on taxpayer's behalf, and retained the balance as part of its underwriter's commission. Foster then transferred his property to taxpayer for the $4,358,705.70 cash and 1,000 shares of B stock.

[4] This is confirmed by the testimony of Mr. Eaton, partner of Otis & Company. He testified that Otis & Company was engaged in the "brokerage business" and the "buying and selling of securities" (R. 126); that Otis acted as "the underwriters that bought the securities to resell" (R. 134–135); and that Otis' "gross profit was $2.50 per share of which the dealer got $1." (R. 141.)

(R. 68–70, 161–162.) That Otis paid the cash directly to Foster (on taxpayer's behalf) is entirely consistent with its role of underwriter and scarcely furnishes any basis for assuming, as does taxpayer, that Otis was purchasing Foster's business assets rather than taxpayer's stock. Taxpayer is here attempting to distort a cash purchase of property by a newly organized corporation into a sale of the property to the underwriting firm which organized the corporation and marketed its securities, in the hope of including in its invested capital amounts never paid into it but retained by the underwriter.

Stated in the language of Section 718 (a) all of taxpayer's Class A stock was issued for "money paid in" to it by Otis, and this money together with one-half of its Class B stock was used by taxpayer to purchase "property paid in" to it by Foster. The balance of the proceeds of the sale of the Class A stock, and the other half of the Class B stock, went to Otis as its underwriter's fee.

In any event, this contention involves only a question relating to the particular facts of this case.

3. Taxpayer relies for conflict (Pet. 6; Br. 26–30) solely upon *Hazeltine Corp.* v. *Commissioner* 89 F. 2d 513 (C. A. 3). That case involved the depreciation basis of property acquired by a corporation in exchange for stock. No question of invested capital was even remotely pre-

sented. The court below aptly observed (R. 203) that the case is "far afield", and that (R. 204) the issue here is the entirely different one of whether profits accruing to an underwriter from the sale of stock are includible in the corporation's equity invested capital for excess profits tax purposes. The cases uniformly hold that such profits are not includible, and taxpayer suggests no reason for departing from them here.

CONCLUSION

The decision below is correct. There is no conflict, and no occasion for further review. The petition for a writ of certiorari should be denied.

Respectfully submitted.

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MAY 1951.

U. S. GOVERNMENT PRINTING OFFICE: 1951